Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:CTM:[redacted] POSTF-168290-01
[redacted]

date: JAN 2 3 2002

to: LMSB Division, [redacted]
ATTN: [redacted], Team Coordinator, CTM Group [redacted]

from: LMSB Practice Group, Area [redacted]

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subject: [redacted] - **Liquidation of** [redacted] **and Exchange of** [redacted]

This memorandum responds to your request for advice regarding whether the exchange by [redacted], Inc. (the "Taxpayer") of its interest in the [redacted] in [redacted] qualifies as a like-kind exchange under I.R.C. § 1031.

ISSUE

Whether the exchange by [redacted], Inc. (the "Taxpayer") of its interest in the [redacted] in [redacted] qualifies as a like-kind exchange under I.R.C. § 1031, where

a. [redacted] Associates, the partnership that owned the [redacted], liquidated and distributed the [redacted] to its partners as tenants-in-common, and

b. two weeks later, the Taxpayer transferred its interest as tenant-in-common to [redacted], LLC in exchange for like-kind property.

CONCLUSION

No. In substance, the transaction is a sale of the Taxpayer's interest in [redacted] Associates to [redacted] LLC.

FACTS

I. PLAYERS

[redacted], Inc. (the "Taxpayer") is a [redacted] corporation and a member of the consolidated group of corporations, which has as its common parent [redacted] (USA)

Corporation, a Delaware corporation. The Taxpayer, through subsidiaries and/or partnerships, owns and leases shopping centers in the United States and other countries.

[redacted], Inc. ("[redacted]") is a [redacted] corporation that, like the Taxpayer, owns and leases shopping centers. [redacted] conducts substantially all of its business through [redacted] Limited Partnership ("[redacted] L.P."). See [redacted]'s Form 8-K, Current Report, dated [redacted] and filed with the Securities Exchange Commission ("SEC") on [redacted].

The [redacted] Company ("[redacted]") is a [redacted] corporation engaged in the business of owning, managing, and leasing nonresidential buildings, such as retail centers and office buildings.

II. PARTNERSHIP UNDER EXAMINATION

[redacted] Associates (the "Partnership") is a [redacted] general partnership that was formed in [redacted] for the purpose of developing, constructing, and operating a regional shopping center, known as [redacted], in [redacted]. Prior to [redacted], the Partnership was owned as follows:

[redacted], Inc.	[redacted]%
[redacted], L.P.	[redacted]%

[redacted], L.P. ("[redacted]") is a Delaware limited partnership owned by [redacted] Corporation,[1] a wholly owned subsidiary of [redacted] Corporation and, in turn, [redacted]. See [redacted]'s Form 8-K, Current Report, filed with the SEC on [redacted] and the information available in the Service's Integrated Data Retrieval System.[2]

[redacted] formally took over management of the [redacted] in [redacted]. See [redacted], [redacted].

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[1] [redacted] Corporation was formerly known as [redacted] Corporation.

[2] On [redacted], [redacted] acquired all of the outstanding equity interests in [redacted] Corporation and its affiliated partnership, [redacted], L.P.

III. TRANSACTION UNDER EXAMINATION

A. AGREEMENT BETWEEN THE TAXPAYER, [redacted] AND [redacted]

On [redacted] the Taxpayer, [redacted] and [redacted] entered into an Asset Purchase Agreement. Pursuant to the Asset Purchase Agreement, the Taxpayer and its subsidiaries agreed to transfer certain shopping centers and/or partnership interests in partnerships that owned certain shopping centers.

The Taxpayer placed at least two conditions on the sale of its shopping centers and/or partnership interests to [redacted] and [redacted]. First, it requested that the transfers be effected in transactions that qualify as "like-kind exchanges" as defined in I.R.C. § 1031. The Taxpayer could, no later than two days prior to an applicable closing date, assign its rights under the Asset Purchase Agreement to one or more qualified intermediaries. See Asset Purchase Agreement, § [redacted]. If the Taxpayer made this choice, [redacted] and [redacted] agreed to pay all cash consideration to the qualified intermediaries. See id. Second, in the case of the transfer of partnership interest, the Taxpayer could elect, in its sole discretion, to dissolve and liquidate the assets of the partnership, resulting in a tenancy-in-common arrangement between the Taxpayer and the partnership. See Asset Purchase Agreement, § [redacted]. The tenancy-in-common agreement would contain the same substantive terms as the partnership agreement, except for such modifications necessary to reflect the difference in ownership structure. See id. at § [redacted].

B. TRANSFER OF [redacted]

As part of the Asset Purchase Agreement, the Taxpayer agreed to transfer its interest in [redacted] to [redacted].[3] The transfer was effected using the following steps:

1. [redacted] and [redacted]

   a. On [redacted] the Taxpayer and [redacted] executed a Public Notice of Dissolution of Partnership stating that the Partnership was

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[3] We do not have the Disclosure Schedule associated with the Asset Purchase Agreement. We, therefore, cannot determine whether the Taxpayer agreed to transfer its partnership interest in the Partnership or its interest in [redacted] It is important to obtain the Disclosure Schedule to understand the intent of the parties as to what the Taxpayer transferred to [redacted] and [redacted].

dissolved effective as of [redacted] and that [redacted] Inc., a subsidiary of [redacted] will manage the business of the former partnership.

b. On [redacted], the Partnership entered into the [redacted] Property Management Agreement with [redacted] Inc.

[redacted] Inc., as manager, had the following duties: (1) leasing of space, (2) operation, maintenance, repair, and day-to-day management of property, (3) supervision of installations and improvements in space leased as required by the terms of the lease, (4) supervision of parking lot, (5) cleaning of common and other public areas, (6) cleaning and janitorial services as required by the terms of the lease, and (7) negotiation of contracts for electricity, gas, steam, landscaping, telephone, fuel, oil, maintenance, vermin extermination and other services.

c. On [redacted] the Partnership conveyed to the Taxpayer a [redacted] percent undivided interest as tenant-in-common and [redacted] a [redacted] percent undivided interest as tenant-in-common in the [redacted].

2. [redacted]

a. On this date, the deed showing the conveyance of the [redacted] to the Taxpayer and [redacted] was recorded with the [redacted] Recorder's Office.

b. The Partnership assigned to the Taxpayer a [redacted] percent undivided interest as tenant-in-common and [redacted] a [redacted] percent undivided interest as tenant-in-common to the Partnership's right, title, and interest in all the leases, licenses, and other occupancy agreements affecting the [redacted].

c. The Taxpayer and [redacted] entered into a Tenancy-In-Common Agreement.

As required, the Tenancy-In-Common Agreement is substantially similar to the partnership agreement.

In the agreement, the parties agree to file an election under I.R.C. § 761(a) in the manner provided by the regulations to be excluded from the provisions of subchapter K. The agreement further states, "In the event it is determined, contrary to the intent of the Tenants, that for purposes of the Internal Revenue Code of 1986 . . . that a partnership exists, the Tenants hereby elect under Section 761(a) of the Code . . . (x) not to have the provisions of subchapter K of the Code . . . apply to their interests in the Property and (y) to be treated solely as owning their respective undivided interests in the Property." Tenancy-In-Common Agreement, § 1.1.

d. The Taxpayer and [redacted] filed a Termination of Statement of Partnership of [redacted] Associates.

3. [redacted]:

a. The Taxpayer conveyed its [redacted] percent undivided interest as tenant-in-common in the [redacted] to [redacted] LLC, a [redacted] limited liability company whose sole member is [redacted], a subsidiary of [redacted].

The Taxpayer conveyed its interest to [redacted] LLC via the [redacted] Corporation.

b. The Taxpayer assigned its [redacted] percent undivided interest as tenant-in-common in the leases, licenses, and other occupancy agreements affecting the [redacted] to [redacted] LLC.

While we assume that the Taxpayer assigned its rights and obligations under the Tenancy-In-Common Agreement to [redacted] LLC, we did not find such a document in the files provided.

Even though the parties held their interests in [redacted] as tenants-in-common, they continued to use the Partnership's bank account and continued to use the same accounting methods used in maintaining [redacted]'s books and records. That is, the parties did not create separate ledger accounts to which they could allocate directly each party's share of income. Furthermore, it does not appear from the Closing Binder that the parties notified all of the tenants of the transfer from the Partnership to the Taxpayer and [redacted].[4] It appears that the parties did not notify the tenants individually of the Partnership's dissolution until [redacted].[5]

The parties, however, did notify the public of the dissolution of the Partnership. And the Taxpayer claims that it reported the income and expenses from the [redacted] for the period between [redacted] and [redacted] directly on its [redacted] income tax return.[6]

DISCUSSION

Generally, a taxpayer will not recognize gain or loss on the exchange of property held for productive use in a trade or business or for investment[7] if such property is exchanged solely

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[4] The Partnership did notify "REA parties." See Tab [redacted] of the Closing Binder. Tab [redacted] only includes three letters. Consequently, we concluded that the Partnership did not notify all of the tenants, just those that were REA parties.

[5] The letter dated [redacted] states, "[redacted]."

[6] The information presented is somewhat confusing, and consequently, we cannot verify the Taxpayer's claim. We do note, however, that the document entitled, "Tax Income Statement, [redacted]" includes total real estate rental revenues and expenses for the Partnership, not the Taxpayer's share of such items. See Form 8825, Rental Real Estate Income and Expenses, attached to the Partnership's [redacted] U.S. Partnership Return of Income, Form 1065.

[7] See Memorandum dated [redacted] discussing whether an exchange of property immediately preceded by a tax-free distribution of such property from a partnership will satisfy the requirement that the property be held for productive use or investment. See Bolker v. Commissioner, 81 T.C. 782 (1983),

for property of like kind which is to be held either for productive use in a trade or business or for investment. I.R.C. § 1031(a). The taxpayer, however, cannot apply this general nonrecognition rule to the exchange of, among others, a partnership interest. I.R.C. § 1031(a)(2)(D). For these purposes, an interest in a partnership that has made a valid election under I.R.C. § 761(a) to be excluded from the application of subchapter K is treated as an interest in each of the partnership's assets. I.R.C. § 761(a)(2).

In this case, the Taxpayer has structured the transaction to avoid the provisions of I.R.C. § 1031(a)(2)(D). Undoubtedly, a taxpayer may arrange his affairs, by means which the law permits, to minimize the amount of his income taxes. Gregory v. Helvering, 293 U.S. 465, 469 (1935). But the means employed must have a purpose, other than tax avoidance, and may not be an "elaborate and devious form of conveyance masquerading" as something else. See id. at 469-70. "To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id.

It is a well-settled principle of tax law that the substance, not the form, of a transaction determines its tax consequences. Crenshaw v. United States, 450 F.2d 472, 475 (5th Cir. 1972). The tax consequences of a transfer of property, therefore, is not determined solely by the means employed to transfer legal title. Commissioner v. Court Holding Co., 324 U.S. 332, 334 (1945). They are determined by viewing the transaction as a whole and considering each step from the commencement of negotiations to the consummation of the sale. Id. "To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress." Id.

While in form, the transfers in this case look like a dissolution of a partnership followed by a like-kind exchange under I.R.C. § 1031, in substance, the transfers are nothing more than a disguised sale of a partnership interest.

First, the business of the Partnership did not cease after the alleged dissolution. That is, the Taxpayer and [redacted] (through related entities) continued to operate the [redacted] after [redacted]. And [redacted] continued to operate

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aff'd, 760 F.2d 1039 (9th Cir. 1985) and Magneson v. Commissioner, 81 T.C. 767 (1983), aff'd, 753 F.2d 1490 (9th Cir. 1985).

the [redacted] after [redacted]. These facts prove to be a key factor in determining whether a transaction in substance is a sale of a partnership interest. See Kinney v. United States, 228 F. Supp. 656, 662-64 (1964), aff'd, 358 F.2d 738 (5th Cir. 1966).

In Kinney, the taxpayer sought to extract himself from a milling business operated through a partnership owned by him and Edward Stine. Stine wanted to operate the mill as an individual and offered to buy out the taxpayer's interest. The parties agreed to the following terms: (1) transfer of the land, improvements, and depreciable assets owned by the partnership to a newly formed corporation in exchange for its stock, (2) dissolution of the partnership, (3) granting of an option to Stine to purchase the taxpayer's stock, and (4) transfer of the taxpayer's interest in the other assets of the partnership to Stine in exchange for cash, the assumption by Stine of all partnership liabilities, and the cancellation of certain debts owed by the taxpayer. The character of the loss incurred by the taxpayer on the transaction depended on whether the transaction was a sale of a partnership interest or a distribution of partnership assets and the subsequent sale of those assets by the taxpayer to Stine. In concluding that the taxpayer sold his interest in the partnership to Stine, the court found Stine's continuation of the partnership's business significant. Despite the formalities, the court found that the business of the partnership did not terminate, and consequently, the partnership did not dissolve.

The facts in this case are similar to the facts in Kinney. The Taxpayer sought to extract itself from the retail shopping center industry. To do so, it entered into the Asset Purchase Agreement with [redacted] and [redacted], both of which already had substantial interests in the shopping centers to be exchanged and wanted to continue their operation. The Taxpayer elected, as permitted by the Asset Purchase Agreement and in keeping with its intent to take advantage of the provisions of I.R.C. § 1031, to have the transfer of its interest in the [redacted] structured as a liquidation of the Partnership followed by the sale of the Taxpayer's share of the Partnership's assets to [redacted] LLC. Like the business of the partnership in Kinney, however, the business of the Partnership did not cease but was continued by [redacted] and its affiliates. And the parties clearly intended this result. Furthermore, the Taxpayer has not established a legitimate business purpose, other than tax avoidance, for structuring the transaction this way. Therefore, like the transaction in Kinney, the transaction here should be viewed as in substance a sale of partnership interest.

Second, the tenancy-in-common arrangement between the Taxpayer and [redacted] falls within the broad definition of "partnership" under I.R.C. § 761(a). I.R.C. 761(a) defines the term "partnership" to include "a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not . . . a corporation or a trust or estate." Stated differently,

> A joint venture or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. For example, a separate entity exists for federal tax purposes if co-owners of an apartment building lease space and in addition provide services to the occupants either directly or through an agent. Nevertheless, a joint undertaking merely to share expenses does not create a separate entity for federal tax purposes. . . . . Similarly, mere co-ownership of property that is maintained, kept in repair, and rented or leased does not constitute a separate entity for federal tax purposes. For example, if an individual owner, or tenants in common, of farm property lease it to a farmer for a cash rental or a share of the crops, they do not necessarily create a separate entity for federal tax purposes.

Treas. Reg. § 301.7701-1(a)(2).

Obviously, a determination that a joint venture or contractual arrangement is a partnership depends on the facts and circumstances, the essential question being whether the parties intended to, and did in fact, join together for the conduct of a business. Commissioner v. Culbertson, 337 U.S. 733, 741-42 (1949); Gabriel v. Commissioner, T.C. Memo. 1993-524. Factors none of which is conclusive but all of which are relevant to the determination include the agreement of the parties; the conduct of the parties in executing the agreement's provisions; the parties' control over income and capital; whether each party was a principal and coproprietor, sharing a mutual proprietary interest in the net profits and having an obligation to share losses; whether business was conducted in the joint names of the parties; whether the parties filed partnership returns; whether separate books of account were maintained for the venture; and

whether the parties exercised mutual control over and assumed mutual responsibilities for the venture. Luna v. Commissioner, 42 T.C. 1067, 1077-78 (1964).

Here, the Taxpayer and [redacted] clearly intended to join together in the conduct of a business when it executed the partnership agreement in [redacted] and acted consistently with its terms. The parties established a separate name and bank accounts for the Partnership and held themselves as partners to the Service, the [redacted] tenants, creditors, and others.

This intent did not change when the parties opted to change the form of ownership in [redacted] and hold their interests in the [redacted] as tenants-in-common. Other than notifying the public, the mall anchors, and creditors of the Partnership's dissolution, the parties did not alter their behavior.

Admittedly, the definition of partnership does not include mere ownership of property by tenancy-in-common. Treas. Reg. § 1.7701-1(a)(2); Estate of Appleby v. Commissioner, 41 B.T.A. 18, 20-21 (1940), aff'd, 123 F.2d 700 (2nd Cir. 1941). The parties, however, cannot avoid partnership classification simply by designating a joint undertaking as a tenancy-in-common or by expressly providing that the undertaking is not to be considered a partnership. Gabriel, T.C. Memo. 1993-524. That title is taken as tenants-in-common is not determinative and may be considered neutral evidence. McManus v. Commissioner, 583 F.2d 443, 447 (9th Cir. 1978), cert. denied, 440 U.S. 959 (1979).

The distinction between mere co-owners and co-owners engaged in a partnership lies in the degree of business activity of the co-owners or their agents. Marinos v. Commissioner, T.C. Memo. 1989-492. Here, the Taxpayer and [redacted] were not mere investors in [redacted]; they conducted the same business activity that they did prior to the creation of the tenancy-in-common. In fact, the parties entered into a tenancy-in-common agreement that was virtually identical to the partnership agreement.[8] Furthermore, the parties continued to conduct business as a partnership, keeping their books on a partnership basis and maintaining a partnership bank account.

Because the tenancy-in-common arrangement between the Taxpayer and [redacted] falls within the definition of partnership under I.R.C. § 761(a), the Taxpayer's tenancy-in-common interest

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[8] As already noted, according to the Asset Purchase Agreement, the tenancy-in-common agreement was required to be substantively identical to the partnership agreement.

in [redacted] should be treated as a partnership interest, and the Taxpayer's transfer of its tenancy-in-common interest to [redacted] LLC should be treated as a transfer of a partnership interest to [redacted] LLC. Accordingly, the Taxpayer is not entitled to nonrecognition treatment under I.R.C. § 1031 with respect to the exchange of its tenancy-in-common interest in [redacted], because the provisions of I.R.C. § 1031 do not apply to any exchange of partnership interests. See I.R.C. § 1031(a)(2)(D).

Third, the Taxpayer and [redacted] are not eligible to make an election under I.R.C. § 761(a) to be excluded from the provisions of subchapter K. An organization falling within the definition of partnership under I.R.C. § 761(a) may elect to be excluded from the provisions of subchapter K if the organization is availed of

> (1) for investment purposes only and not for the active conduct of a business,
> (2) for the joint production, extraction, or use of property, but not for the purpose of selling services or property produced or extracted, or
> (3) by dealers in securities for a shore period for the purpose of underwriting, selling, or distributing a particular issue of securities,
>
> if the income of the members of the organization may be adequately determined without the computation of partnership taxable income.

I.R.C. § 761(a). An organization will be availed of for investment purposes only

> [w]here the participants in the joint purchase, retention, sale, or exchange of investment property -
>
> (i) Own the property as coowners,
> (ii) Reserve the right separately to take or dispose of their shares of any property acquired or retained, and
> (iii) Do not actively conduct business or irrevocably authorize some person or persons acting a representative capacity to purchase, sell, or exchange such investment property.

Treas. Reg. § 1.761-2(a)(2).

Because the Partnership, reformulated as a tenancy-in-common, does actively conduct a business with respect to the [redacted] it is not an entity eligible to elect out of subchapter K under I.R.C. § 761(a).

If you have any questions, please call me at (619) 557-6014.

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[redacted]
Associate Area Counsel (LMSB)

By: /s/
[redacted]
Attorney